No. 513

In the Supreme Court of the United States

OCTOBER TERM, 1959

UNITED STATES, PETITIONER

v.

CANNELTON SEWER PIPE COMPANY

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

REPLY BRIEF FOR THE UNITED STATES

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I

THE RECORD IN THIS CASE SQUARELY AND INESCAPABLY PRESENTS THE STATUTORY ISSUE POSED BY THE PETITION

Taxpayer suggests (Br., Point I) that the record in this case does not raise the statutory issue presented by the Government—a suggestion which is remarkable not only because that issue is as central to this case as the Prince of Denmark is to *Hamlet,* but also because taxpayer advised this Court, in its brief in opposition to the petition for certiorari, that "The question in this case is *solely* one of statutory construction" (Br. in Op., p. 5; emphasis added). Taxpayer, having only recently assured the Court that this *sole* issue was correctly decided below, counsels today that this issue should be studiously avoided. It

was right the first time; the scope of "mining" under the depletion statute is the issue; and the question is whether that issue was correctly decided below.

The court below was under no illusions as to the basic issue in this case. "The question squarely presented," it stated (R. 267), is "whether the statutory language which defines, as a part of 'mining', 'all ordinary treatment processes normally applied by mine owners' to produce 'the commercially marketable mineral product or products', includes all processes necessary by a taxpayer to obtain a product *which can be sold by it at a profit*" (emphasis in original). This was the "overriding" issue, the Court of Appeals concluded, because the Government's proof clearly established that raw fire clay and shale were commercially marketable in the sense that they are mineral products which have commercial value and are bought and sold in "substantial" quantities (*ibid.*). The substance of this proof it described as follows (R. 270–271):

> * * * As it [the Government] points out, in this case it did not admit the nonmarketability of fire clay and shale. Indeed, the Government's evidence indicates that large quantities of fire clay and shale were sold during the tax year, 1951. Thus, in Indiana, of 82 companies engaged in the production or consumption of fire clay and shale, 32 purchased fire clay or shale, or both, for use in their manufacturing operations. Seven producers of fire clay and two producers of shale in Indiana engaged in nonintegrated operations, that is, strictly in the extraction of the raw fire clay

and shale and not in further processing. These companies necessarily took depletion on the raw fire clay and shale which they sold. Taxpayer's own expert witness, Haydn H. Murray, admitted, on cross-examination, that over 300,000 short tons of fire clay (of some 500,000 short tons produced) were sold in Indiana in 1951 rather than used by the producer in integrated manufacturing operations.[1]

Moreover, the District Court's conclusion that taxpayer is entitled to a recovery rests directly upon findings (1) that "finished products" constitute the "first 'commercially marketable mineral products' of the fire clay and shale mined by plaintiff" (Fdg. 13, R. 5), and (2) that the processes applied by taxpayer "were processes normally applied by mine owners or operators who are engaged in the manufacture of vitrified clay sewer pipe and related products" (Fdg. 10, R. 5). The first of these "findings" is untenable if the term "commercially marketable mineral products," as used in the statute, refers to the commercially valuable constituent of the mine, whether or not such constituent is actually sold, or could be profitably sold, by the individual taxpayer. The second "finding" is legally immaterial if the statute restricts the taxpayer to the processes normally applied by mine owners *as mine owners* (certainly, the normal reading), and does not include processes

[1] In addition to the Indiana producers to whom the Court of Appeals' opinion refers, the record shows that a Kentucky miner, directly across the river from Cannelton, Indiana, mined large quantities of both fire clay and shale for the use of the Owensboro Sewer Pipe Company and others. R. 166–167, 171–177.

which mine owners would use if they also happened to be sewer pipe manufacturers.

Since this record unmistakably establishes that there is a regular commerce in raw minerals of the kind which taxpayer mines, the case sharply poses the issue whether taxpayer, in the face of this established fact, could take depletion on the basis of the gross receipts received from the sale of manufactured sewer pipe. It is equally plain, as the Court of Appeals observed (R. 267), that if the legal theory upon which judgment was entered for the taxpayer does not satisfy the requirements of the statute, that judgment should not be sustained on appeal. Taxpayer had the burden of establishing its claim for refund and it must show that the judgment entered in its behalf has a proper legal foundation. It must affirmatively establish the correctness of *its* theory (*Interstate Transit Lines* v. *Commissioner*, 319 U.S. 590, 593), *i.e.*, that it was entitled, as a matter of law, to recover upon a showing that it could not profitably market raw fire clay and shale. This would be so even if it could fairly be said that various legal arguments advanced by the Government in the District Court were erroneous. See *United States* v. *Bess*, 357 U.S. 51, 54–55; *Hormel* v. *Helvering*, 312 U.S. 552; *Helvering* v. *Richter*, 312 U.S. 561.

Taxpayer contends that in the District Court the Government attempted, but *failed*, to show that taxpayer could have competed effectively in the Indiana raw mineral market. Taxpayer also questions whether this Court may properly take notice of statistics (appearing in the "Minerals Yearbook" of the Bureau of

Mines and the "Census of Mineral Industries" prepared by the United States Department of Commerce) which show that raw fire clay and shale are generally sold throughout the United States. Neither of these arguments detracts from the conclusion that the issue presented by the Government's petition is squarely raised by this record.

If the Government's proof had shown that taxpayer could have profitably marketed fire clay and shale, that would have put an end to the case even on taxpayer's theory. An attempt to make such a showing and to negate, on the facts, the asserted basis of recovery is not, of course, a concession that taxpayer's theory is a correct one. The Government, moreover, did not rest on evidence bearing on the question whether taxpayer's costs permitted it to compete effectively in the Indiana mineral market. It undertook to show further—and it *succeeded* in showing—by the testimony of a series of witnesses that there was in Indiana (as well as in Kentucky) a regular and substantial commerce in raw fire clay and shale. See R. 84, 144, 148–149, 153–154, 157–158, 166–171, 175, 178–179. It also elicited, on cross-examination of taxpayer's expert, that 300,000 tons of raw fire clay were sold in Indiana alone in the tax year involved (R. 137). Thus, the Government proved—though that was not its burden—that on a correct legal theory there could be no recovery.

We believe further that, *if it were necessary*, figures of the kind incorporated in the United States Census might be the proper subject of judicial notice.

Since that is not necessary—the testimony of record being more than adequate—there is no need to labor the point. As the Court of Appeals recognized, the existence of a regular commerce in raw fire clay and shale was conclusively established (R.270–271).

We note finally that our contention as to the scope of mining under the depletion statute was raised in the pleadings and preserved throughout the District Court proceedings. Taxpayer's complaint alleged that it was entitled to compute its depletion with reference to its "gross sales of vitrified sewer pipe" (par. 21, R. 253); that the Commissioner had refused to allow depletion on that basis (par. 23, R. 254); and, further, that he had determined that certain of the processes included by taxpayer were manufacturing, rather than mining, processes and should be excluded from "gross income from the property" (*ibid.*). The Government's answer defended the correctness of the Commissioner's determination and denied that the statute permitted taxpayer to compute its depletion on the basis of the sale of its finished products (pars. 21, 23, R. 261). At the trial, as stated above, the Government offered evidence of a regular commerce in raw fire clay and shale. At the conclusion of the proceedings, the Government submitted a brief which argued (as to the statutory issue) two points: (1) "The gross income from mining is limited to the gross income from the sale of the first commercially marketable product of a given mineral"; and (2) "The first commercially market-

able mineral product of Pennsylvanian underclay is crude clay and shale."[2]

This case, as heard and decided below, stands squarely for the proposition that a miner-manufacturer who mines fire clay and shale, and thereafter fabricates those mineral products into sewer pipe, may be permitted to take depletion on a basis twenty or more times greater than non-integrated miners of fire clay and shale—some of whom appeared in the District Court in this very case. It has since been interpreted by other courts as authorizing the individual miner-manufacturer to compute his depletion allowance on the basis of the particular end product which he finds it profitable to make and sell. See *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398 (C.A. 8th); *Dixie Fire Brick Co.* v. *United States*, 4 A.F.T.R. 2d 5368 (N.D. Ala.); *Eastvale Clay Products Co.* v. *United States*, 4 A.F.T.R. 2d 5581 (W.D. Pa.); *Standard Clay Mfg. Co.* v. *United States*, 176 F. Supp. 590 (W.D. Pa.). The *sole* issue (as taxpayer itself recognized only a few months ago) is whether the

[2] In the course of the argumentation, it was stated, *inter alia*, that "percentage depletion is to be based [on] the *first* commercially marketable mineral product and not just any mineral product a given producer may decide to produce" (pp. 14–15); that "[i]f Congress had intended to say 'processes normally applied by mine owners and operators' to arrive at their commercially marketed product it could have done so" (p. 21); and that "it is the deposit which is depleted and which is subject to an allowance for depletion, not the finished manufactured product" (p. 22). A copy of this brief is being filed with the Clerk of the Court.

statute, as enacted by Congress, authorizes such results.[3]

II

TAXPAYER'S VIEW THAT THE PRODUCT ON THE BASIS OF WHICH MINERAL DEPLETION IS TAKEN MAY VARY FROM TAXPAYER TO TAXPAYER WITHIN THE SAME BRANCH OF THE MINING INDUSTRY RESTS UPON A MISCONSTRUCTION OF THE STATUTE AND IS IRRECONCILABLE WITH THE LEGISLATIVE HISTORY. THE "CUTOFF" IS THE BASIC MINERAL PRODUCT FIT FOR SALE OR COMMERCIAL USE

A. One thing emerges plainly from the two extensive opening briefs filed in this case: that there is a fundamental difference between the litigants as to the proper interpretation of the words "commercially marketable mineral product," as they appear in the statute. The Government does not assert, as taxpayer suggests, that those words may be read out of

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[3] Taxpayer suggests that the conclusion to the Government's brief—suggesting that the case be remanded so that taxpayer's gross income from mining may be determined in the light of the correct legal criteria—indicates that the Government is seeking a trial *de novo*. On the contrary, we contend that the evidence and findings below require the conclusion that taxpayer's gross income from mining is to be computed with reference to the value of its raw fire clay and shale, rather than with reference to the value of its finished products. We suggest a remand because it is properly the function of the District Court to make the necessary computations. Under the pertinent Regulations (see our main brief, pp. 60, 95–96), if an integrated producer does not sell the basic mineral product, it must be determined if there is a representative field or market price which may be utilized. If there is none, there must be a constructive computation of gross income from mining, *i.e.*, one must determine the ratio of mining costs (including ordinary mineral processing) to non-mining costs and apply the percentage represented by the former to the gross receipts received from the finished products actually sold, thus eliminating the values attributable to the extraordinary processing.

the statute. Nor does it claim for a moment that the words are not an integral part of the statutory definition which Congress has prescribed for purposes of determining the depletion base.[4] The dispute is as to what the words mean—what the "commercially marketable products" rule (as taxpayer phrases it) is.

Simply stated, the Government's view is that it is an industry-wide rule which restricts miners of the same class to the same basic marketable product. Applied to this case, the rule means that miners of fire clay and shale are to compute the gross income from their mining properties on the basis of the value of those minerals in raw form—the record conclusively establishing that they are marketable in that form. The Government's interpretation of the statutory definition precludes the view that the non-integrated miner of fire clay and shale is to get but a small fraction, per ton of mineral, of what the integrated miner obtains.

Taxpayer's view, candidly stated in its brief, is that the standard may vary from taxpayer to taxpayer, so that one will take depletion on a relatively primitive product and another on an advanced manufactured product. Thus, taxpayer flatly states (Br., p. 57) that a taxpayer's gross income is not to be determined "on the basis of the first commercially marketable product obtained by some other miner or miners of the same mineral." Its argument, in es-

[4] We *do* stress that they are to be read in conjunction with the antecedent language—"ordinary treatment processes normally applied by mine owners or operators in order to obtain * * *."

sence, is that the first product which the individual producer finds it *profitable* to make is the product with reference to which he may compute depletion. This taxpayer, making sewer pipe which sells for approximately $40 a ton, claims depletion on that basis, whereas other miners of the same minerals must take it on the basis of their sales of raw fire clay and shale, minerals sold in most instances for less than $2 a ton. Presumably, if taxpayer were to find it profitable to begin making all of its fire clay and shale into substantially more expensive products, selling at $80, $120 or $160 a ton, it would claim an allowance for exhaustion of its clay on a basis two or three or four times greater than the base which it now claims (a base which already yields it more than double the price which it would have to pay to buy fire clay and shale on the market).[5]

Congress, to be sure, recognized that most minerals require treatment to give them realizable value.

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[5] It is notable that in 1957 taxpayer began obtaining its fire clay and shale from a miner across the river in Kentucky (see R. 68)—the same miner who in 1951 (the taxable year here involved) delivered clay to the Owensboro Sewer Pipe Company at $1.40 a ton (R. 163–172). As taxpayer's vice-president testified (R. 68), the clay across the river is suitable and is cheaper. Apparently, Cannelton now claims the economic interest in this mine—having leased the land for the sum of $1 (R. 179)—and asserts, *on the basis of the value of its sewer pipe*, a depletion allowance of approximately $1 a ton for minerals which the contract miner is able to deliver at a price in the neighborhood of $1.40 a ton. Taxpayer assures this Court (Br., p. 116) that such a result is "not discrimination." We would say that it documents the proposition that non-integrated miners will not survive if integrated miners may completely pervert the depletion allowance.

Therefore, instead of restricting depletion to the value of the mineral in its natural state, it undertook to allow depletion on the basis of the value of the mineral after it had been treated (by "ordinary treatment processes normally applied by mine owners or operators") to that initial point where it was in a condition fit for sale or use and could ordinarily be associated with a field or market price. We do not read "commercially marketable mineral product" out of the statute. We say, rather, that those words refer to the commercially valuable constituent of the deposit—or, to use the words of the Chairman of the Tax Committee of the American Mining Congress, to the mineral put in "marketable condition" (see our main brief, p. 87). This view, we believe, gives effect to the underlying purpose of depletion—to allow an ascertainable and reasonably uniform measure of compensation for the exhaustion of the mineral asset itself—and, at the same time, it gives meaning to all of the language of the statutory definition. Without restating at length the arguments made in our original brief, we point out in summary form—

(1) "Ordinary treatment processes normally applied by mine owners or operators" can hardly be taken to contemplate the inclusion of processes which a mine owner could never normally apply unless he also happened to be something else in addition, *i.e.*, a fabricator or manufacturer. (We are not saying, as taxpayer appears to believe, that the line which determines what is included within the statutory definition of mining and what is not is a line to be drawn between "mining" and "manufacturing." Under our

view, manufacturing processes are, as a practical matter, excluded. The reason is that we believe that there is no instance in which it can be shown that such processes are normally applied by mine owners in order to obtain the valuable constituent of a mine. *Non*-manufacturing activities are also broadly excluded where they are unnecessary for purposes of putting the particular mineral in marketable condition.)

(2) The processes which Congress has set forth as a "reasonable specification of what are to be considered [includible] processes for various *kinds* or *classes* of mines" [6] fall into three categories: (a) those which involve "unscrambling" of the valuable constituent, *i.e.*, its separation from waste matter and impurities; [7] (b) those which involve preparation for shipment—processes such as drying, screening, or crushing, where such are necessary for the particular mineral concerned; (c) activities which are a necessary incident of (a) or (b), such as transportation to the place where the ordinary treatment processes are applied.

(3) The "commercially marketable mineral product" to which Congress made reference is the product *obtainable by* application of the *ordinary* treatment processes which mine owners normally apply—from which it follows that more advanced products obtained

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[6] S. Rep. No. 627, 78th Cong., 1st Sess. (App. B, pp. 210–211; emphasis added).

[7] As shown, *infra*, pp. 21–26, 30–32, cyanidation and leaching, listed processes to which taxpayer makes particular reference, are separation processes which Congress has allowed for that reason.

by processes which are not the ordinary and normal processes of miners are not the products to which Congress had reference.

In the usual situation—as Congress contemplated [8]—it is a simple matter to determine the first marketable product of a branch of the mining industry. For example, if there is a regular commerce in iron ore of shipping grade (as is, of course, the case), that, as all miners of iron ore are assuredly aware, is the commercially marketable mineral product produced by that branch of the mining industry. Iron ore is no less a marketable product because some integrated miner-manufacturers find it unprofitable (or less profitable) to sell the ore and proceed to make it into pig iron or structural steel. This case falls into the same category, since the record shows a regular commerce in raw fire clay and shale. The sales furnish conclusive proof that these minerals are in commercially marketable condition in their raw form.

Admittedly, the more difficult case is one in which there are no sales of the mineral prior to manufacture because *all* of the mines are part of integrated enterprises. We do not think that the statute need be read, or should be read, to permit an extension of depletion on the basis of industry-wide vertical integration. Such integration does not prove that the mineral must be processed further to be put in a condition where it is commercially valuable; it simply reflects the fact that each producer of the mineral has provided his own market intramurally.

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[8] See main brief, Point II, pp. 43, 49–51.

But even if one were to conclude, contrary to our view, that the words "commercially marketable" dictate a requirement that sales in the industry be shown before a cutoff can be established, that would not avail this taxpayer. Such a conclusion cannot rest on a case such as *Merry Brothers,* in which the court took the view that the total absence of sales of brick clay (as was assumed on the pleadings) enabled producers of that mineral to take brick as the basis of depletion. Since, as found by the court below, there *is* traffic in fire clay and shale, taxpayer must take another long and significant step; it must argue that a product is not to be deemed commercially marketable, *even though widely sold,* if a particular producer could not sell it *profitably.* It must convince the Court that the statute permits those mines which are by hypothesis less valuable (those that could not compete effectively in the market) to get virtually unlimited depletion allowances (by going on to expensive finished products whose ultimate sales prices bear no fixed relation to the value of the ingredient mineral), and will confine only the more valuable mines (those which can clearly produce below the market price) to processes within the concept of mining.

B. Such, broadly, is the difference in approach between the Government and respondent. As to the specific objections which taxpayer has advanced to the arguments elaborated in our main brief:

1. Taxpayer argues that the plural reference to "products" in the phrase "commercially marketable mineral product or products" indicates that Congress did not intend to confine depletion to a single basic

product for each branch of the mining industry. (Br. 59–60.) As we pointed out in our main brief (pp. 27–28), however, the plural reference to "products" appears to be merely a recognition that one mining operation (as in this case) may yield more than one mineral (here fire clay *and* shale) and that a single ore frequently yields different minerals.* Congress' awareness of this is reflected in Section 114(b)(4)(B), subparagraph (iv), which speaks of the "processes used in the separation or extraction of the product or products from the ore * * *." Taxpayer says that this explanation "inherently concedes that the statutory phrase, 'the commercially marketable mineral product or products,' refers to the 'product or products' of a particular mining operation, not to a single, industry-wide 'basic product' of the particular mineral." (Br. 60.) But recognition of the fact that a single mining operation may produce more than one mineral certainly does not answer the question, "What are the depletable mineral products"? In our view, "product or products" refers to the mineral or minerals, and the term "commercially marketable mineral product or products" refers simply to the mineral or minerals put in marketable condition. We do not say that the correctness of this construction is conclusively established by the reference in subparagraph (iv) to

* "In the mining industry, gold, silver, copper, lead, and zinc are closely related in both the genesis and the geologic occurrence of their ores, as well as in mining and in metallurgical treatment. Of their ores some contain all five metals, many contain three or four, and few contain only one. * * *" *Mineral Resources of the United States* (1930), Part 1, Metals, U.S. Dept. of Commerce, Bureau of Mines, p. A121.

the minerals as the products, but the reference certainly corroborates, rather than refutes, our view.

It is commonplace, we point out, to refer to the valuable constituent of a mineral deposit as the "mineral product." As far back as 1916, the depletion statute—which at that point had no concern with marketability, but referred to value "at the mine"—spoke of the mineral as the "product" of the mine.[10] Similarly, the mining industry itself refers to the minerals (with the necessary processing to make them marketable) as the "products" of mining.[11] The word "product" is frequently used interchangeably with "mineral product"—both referring to the valuable constituent of the mineral.[12]

It is clear, moreover, that until recently the mining industry had no difficulty with the import of the definition. After 1943, when the "commercially marketable" language first appeared in the statute, a veritable parade of mining industry representatives appeared before Congress, session after session, to seek percentage depletion on minerals for which that method had not yet been authorized. As pointed out in our main brief (pp. 76–80) and fully documented in

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[10] Revenue Act of 1916, Sec. 5 (App. B, pp. 2–3); see, also, Treasury Regulations 33 (1914 ed.), Art. 142 (App. B, pp. 1–2), and Treasury Regulations 62 (1922 ed.), Art. 201 (App. B, p. 6).

[11] See, *e.g.*, the testimony of Robert M. Searles during the 1942 Silver Subcommittee Hearings (App. B, pp. 165–166); Dickinson, *Depletion—Gross Income—The Property*, 18–19 Mining Congress Journal (1932–1933) (App. B, pp. 466–468).

[12] See *Forbes* v. *Gracey*, 94 U.S. 762, 766; Hoover, *The Economics of Mining* (1948 ed.), p. 168.

our Appendix B (pp. 316–466), not a single representative of any branch of the mining industry ever suggested that application of the statute to the mineral on which depletion was being sought would confer a right to take depletion on any product more advanced than the particular mineral put into marketable condition. We have listed the products and processes to which they made reference (App. B, following page 500). It is notable that taxpayer has been unable to find a single flaw in this documentation.[13]

2. Taxpayer repeatedly argues (Br. 45–49, 53–55, 61, 63, 64–66) that the Government's interpretation of the statute does not give effect to the words "commercially marketable mineral product."

Its real complaint, however, is that we do not give them an effect which will permit different miners of the same class to take depletion on a disparate basis depending solely upon the degree to which each is integrated. The effect of this language, in our view, is that all miners of the same class may

[13] The farthest taxpayer goes is to attempt to dissociate itself from those who sought depletion for refractory clay on the basis of the "value" of the "raw materials used" (Gov't's main brief, pp. 79–80). It says (Br. 93, n. 45) that since fire clay is a term somewhat broader than the term "refractory clay" (including some clays which are not distinctively refractory), the spokesman for the users of refractory clay did not speak for all users of fire clay. We point out that fire clay and refractory clay (terms which very substantially overlap) were bracketed together by Congress and granted depletion at the same time. Taxpayer's strained argument is to be contrasted with its emphasis at the trial on the proposition that its fire clay had high value because it was "definitely a refractory clay" (R. 119)—indeed, the most refractory clay in Indiana (R. 115–116).

include in "mining" those processes which must be applied in the industry in order to extract and separate the valuable constituent of the deposit and put it into marketable condition. This is the natural construction of the statute—one in keeping with the natural assumption that mining operations would not be conducted if they did not result in obtaining a form of the mineral which was commercially marketable. Congress, we stress, did not refer to the product marketed by each taxpayer but to the marketable product.

The point which clinches, as noted above, is that effect must also be given to the restrictive clause which precedes the reference to the "commercially marketable mineral product," namely, the "ordinary treatment processes normally applied by mine owners and operators in order to obtain" that product. Taxpayer is forced to argue that the words "ordinary treatment processes" includes processes which are employed by those fire clay miners who are also sewer pipe manufacturers, and to rest upon the District Court's finding that Cannelton's processes are normal for mine owners or operators *"who are engaged in the manufacture of vitrified clay sewer pipe and related products"* (Fdg. 10, R. 5; emphasis added).[14] This, despite the fact that we are dealing with a definition of "mining," incorporated in a statute designed to compensate for the exhaustion of the mineral!

[14]Apparently, the only situation in which taxpayer would give effect to the words "ordinary treatment processes" is where a taxpayer, having obtained one product which he could sell at a profit, proceeds to go further in order to obtain a still more valuable product.

3. Contrary to taxpayer's suggestion (Br. 51–53), we are not saying that there is a precise scientific or technical line—one on which all experts would agree—as between mining and manufacturing, or that Congress was attempting to draw such a line. Smelting and refining, for example, are extractive processes—they are certainly not manufacturing and a few experts might even designate them as included in "mining";[15] yet Congress has specifically excluded them. The reason is that the ore concentrate—obtained prior to smelting—is valuable and is, indeed, sold by the non-integrated miner (although it has long been true that most of the principal metals are very largely mined by integrated miners who do their own smelting and refining, and, frequently, their own fabrication).[16]

What *is* established by the "reasonable specification" of processes incorporated in the statute is that Congress has proposed only to allow those ordinary processes employed by the miner, in accordance with regular industry practices, to get something of value:

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[15] Smelting and refining are ordinarily classified as metallurgy. See Newton, *Introduction to Metallurgy* (1948 ed.), p. 1.

[16] The Shepard Report observed, in relation to iron ore, "Probably 95 percent of the entire production is owned or contract-controlled by the smelting companies." Preliminary Report on Depletion, Reports to the Joint Committee on Internal Revenue Taxation from its Staff (1930), Vol. 1, Part 8, p. 73. The percentage of integration in the copper industry is approximately the same. House Hearings, 1959 (Hearings before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes, 86th Cong., 1st Sess.), p. 72.

the useful or saleable product which is the primary object of mining. This standard will frequently exclude non-manufacturing activities. As previously observed, the listed processes fall into three classes: those which are extractive or separative; those which are necessary to put in shipping grade or form; those which are necessary or incidental to the foregoing. The significant point is that Congress has in no instance provided for the inclusion of any process which would take the valuable product of the mining operation—the mineral in its marketable condition—and convert it into a new and different product.

4. In an effort to shake the strong evidence, both in the statute itself and in its history, that Congress proposed to treat each class of miners alike, taxpayer makes an extended argument (Br., pp. 62–63, 84–92) based upon the fact that Congress, in 1943, provided for the allowance of the cyanidation process (used by some miners to extract gold from gold ore) and of leaching (a method sometimes used to extract copper from copper ores). Taxpayer apparently agrees (App. II, pp. 6–8) that these are treatment processes by which the valuable constituents are derived from the ores. What it suggests is that the use of these metallurgical methods yields a purer or more refined mineral product than is obtained by concentration processes (separation by essentially physical means),[17] and that this therefore tends to show that Congress did not propose (as the Government argues) to treat all miners of the same class alike.

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[17] See App. B, p. 496.

The argument, in short, is that Congress has allowed latitude as to the processes which may be employed by the miner to get the valuable constituent of the deposit and that the availability of alternative methods results in the obtaining of different products. Apart from the fact that the argument is not well grounded—taxpayer has made serious errors in its discussion of cyanidation and leaching (as we point out immediately below)—it falls far short of the point which taxpayer must prove. There is a great gap between the proposition that different processes may result in variation in the purity of minerals extracted and the proposition (which Cannelton must establish) that a taxpayer, having obtained the valuable constituent of the mineral, may proceed to include further processing employed in order to convert the first valuable product into a new and different one. To make out an analogy to the instant case, taxpayer would have to show that Congress was prepared to allow individual miners of gold to take depletion on golden chandeliers and individual miners of copper on copper fixtures—subject only to a showing that they could not profitably sell the gold or copper.

Cyanidation of gold: Taxpayer's brief assumes that gold bullion [18] is the first "commercially marketable mineral product" obtained by miners who use the cyanide process, and reasons from this that Congress has allowed such miners a depletable product different

[18] The United States mint accepts shipments of gold and silver, bullion and otherwise, which have a purity of 20 percent or more. *Mineral Facts and Problems* (1956), Bulletin 556, Bureau of Mines, p. 319.

from that obtained by those who extract gold from ore by concentration methods.[19] (When concentration processes are used, there is no question that the ore concentrate is the commercially marketable product since smelting—the next process—is specifically excluded by the statute.) It is true that if all steps in the cyanide process are performed, the last step is one in which gold precipitate (obtained by the prior steps) is melted with a flux and cast into bars for shipment,[20] and that this final step is akin to (or a substitute for) smelting.[21]

We do not, however, agree with taxpayer that the statute permits the inclusion of this last step in the depletion base. What the statute authorizes as an "ordinary treatment process" is "*beneficiation by* concentration * * * *cyanidation,* leaching, crystallization, precipitation (but not including as an ordinary treatment process electrolytic deposition, roasting, thermal or electric smelting, or refining), or by substantially equivalent processes * * *" (emphasis added). "Beneficiation" is virtually synonymous with "concentration"[22] (applied in order to get the ore concentrate

[19] The cyanide process is used primarily in lode mining. See Gaudin, *Principles of Mineral Dressing* (1939 ed.), p. 530; *Mineral Facts and Problems* (1956), *supra*, pp. 317–319; *Gold, Mineral Facts and Problems* (1960 ed.), U.S. Dept. of the Interior, Bureau of Mines, pp. 2–3.

[20] *Mineral Facts and Problems* (1956), *supra*, p. 318; Dorr and Bosqui, *Cyanidation and Concentration of Gold and Silver Ores* (1950 ed.), p. 201; Stoughton and Butts, *Engineering Metallurgy* (1926 ed.), p. 348; Henderson, *Metallurgical Dictionary* (1953 ed.), "cyanidation," p. 99.

[21] *Gold, Mineral Facts and Problems* (1960 ed.), U.S. Dept. of the Interior, Bureau of Mines, p. 3.

[22] See definitions, App. B, p. 496.

which goes to the smelter); in relation to smelting, it means "to concentrate or otherwise prepare for smelting." [23] The cyanide precipitate (equivalent to the concentrate obtained by other methods) is a recognized mineral product (one which is in fact purchased by smelters in substantial quantities) [24] and constitutes the first marketable product under the statute.

This is not merely the view of the Government; it has been that of the mining industry. The industry complaint in 1942 was that the Treasury Regulations (which affirmatively allowed "other processes to the extent to which they do not beneficiate the product in greater degree * * * than crushing and concentrating" (App. B, p. 136)) were being too narrowly applied, and that processes equivalent to concentration (especially the cyanidation of gold and the furnacing of quicksilver) were being disallowed.[25] What the industry sought was the equivalent of concentration—that miners of the same mineral, using different methods, be put on the *same* footing (the direct opposite of taxpayer's thesis). Mr. Fernald, Chair-

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[23] *Webster's New International Dictionary* (1949 ed.).

[24] See *Mineral Commodities of California*, Bulletin 176 (1957), State of California, Department of Natural Resources, p. 223; *Minerals Yearbook* (1951), U.S. Dept. of the Interior, Bureau of Mines, p. 630; *1954 Census of Mineral Industries*, U.S. Dept. of Commerce, Bureau of the Census, Vol 1, pp. 10F–1, 10F–17, 10F–21; Taggart, *Handbook of Mineral Dressing* (1945 ed.), p. 2–75.

[25] See our main brief, pp. 58–59, 61–63; House Hearings, 1942 (App. B, 152–153); Silver Subcommittee Hearings, 1942 (App. B, 172, 174–175, 176–178, 186, 188–189); Senate Debate, 1942 (App. B, p. 197); Senate Hearings, 1943 (App. B, pp. 202–204); Fernald, *Depletion and Related Problems Under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine 141, 143 (1943) (App. B, p. 484).

man of the Tax Committee of the American Mining Congress, stated (App. B, 184) that one should not "exclude the entire cost of the cyaniding process, but only so much of that as was considered as going beyond what a concentrating cost would have been * * *."[26]

Leaching of Copper: Taxpayer also asserts that the leaching of copper results in a "different and more processed" product than the ore concentrate (which is the commercially marketable product obtained by miners who use the concentration method). In this instance, we are not told what the "different and more processed" product is. As to both, taxpayer says that the product is "impure copper." (App. II, pp. 10–11.) Apparently, taxpayer's point is that the leaching of copper, like the cyanidation of gold, is an alternative to smelting and is allowed by the statute, although smelting is not. (See Br. 86.) But, here again, taxpayer has ignored the statute.

Depending upon the grade or type of ore, copper ore is either concentrated or leached.[27] The ore con-

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[26] Like cyanidation, amalgamation produces a product labelled as a precipitate in official publications. See note 24, *supra*. It is only when the amalgamation process is combined with the last part of the cyanidation process that a gold bullion is obtained. See, *e.g.*, *Mineral Commodities of California*, Bulletin 176 (1957), pp. 221–222. That step is not included in the statutory "ordinary treatment processes" for the same reason that the last step in cyanidation is not included.

[27] *Mineral Facts and Problems*, Bulletin 556 (1956), Bureau of Mines, p. 232; *Materials Survey* (Sept., 1952), *Copper*, National Security Resources Board, U.S. Department of the Interior, Bureau of Mines, pp. II–25, II–57 to II–58; see, also, definitions of leaching and precipitation in App. B, p. 499.

centrate obtained from concentrating the higher grades is sent to the smelter, as taxpayer says, but so is the precipitate which is obtained by one method of leaching low-grade oxidized ore.[28] Another method of leaching, in which the last step is called "electrolytic deposition" or "electrolytic precipitation," produces a refined, high-quality copper,[29] "bypassing the smelter entirely."[30] This is apparently the "different, more processed" product of which taxpayer speaks. But the process by which it is obtained, "electrolytic deposition," is expressly excluded by the same statutory provision which excludes smelting.[31]

Taxpayer's examples support, rather than impair, the Government's thesis that Congress proposed to treat all miners of the same class alike. They show that the statute does not operate to permit miners of the same mineral to take depletion on different marketable products (as taxpayer claims), but that it cuts miners off at the *basic* marketable product of

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[28] *Mineral Facts and Problems*, Bulletin 556 (1956), *supra*, p. 232.

[29] *Materials Survey, Copper*, *supra*, pp. II–25 and II–58; *Mineral Facts and Problems*, Bulletin 556 (1956), *supra*, p. 232; see also, Henderson, *Metallurgical Dictionary*, "electrolytic deposition," p. 120; Bateman, *Economic Mineral Deposits* (1952 ed.), pp. 414–415; Fay, *Glossary of Mining and Mineral Property* (1947 ed.), "deposition," p. 211.

[30] *Mineral Commodities of California*, Bulletin 176 (1957), *supra*, p. 176.

[31] This would be true even if "electrolytic deposition" were not excluded by name, since it is only "beneficiation by * * * leaching" (leaching which is equivalent to concentration) which the statute includes in the listed "ordinary treatment processes."

the industry, irrespective of the processes employed to obtain it.[32]

[32] To the extent that miners of bituminous coal sell to some industrial users without breaking and sizing the coal (see our main brief, p. 28; taxpayer's brief, p. 62; taxpayer's App. II, p. 8), it may be argued that Congress, which has specifically allowed breaking and sizing (Section 114(b)(4)(B), subpara. (i), relating exclusively to coal), has permitted the inclusion of processes which are not essential to make bituminous coal marketable. In various respects, coal has been the subject of individual consideration by Congress. See brief filed by the National Coal Association, *amicus curiae*. The argument cannot be carried over to subparagraphs (iii) and (iv) (covering minerals other than coal and sulphur, dealt with in subaparagraphs (i) and (ii)). Subparagraph (iii) allows only the inclusion of named processes to the extent that they are necessary to bring the mineral to shipping grade and form. Subparagraph (iv) allows only the inclusion of named processes to the extent that they are necessary to separate or extract the commercially marketable product from the ore. Moreover, as to the minerals covered by all four subparagraphs, the dominant consideration is that Congress has never countenanced the inclusion of any process which would take the valuable constituent of the mine and convert it into a new and different product. The National Coal Association does not claim in its brief that a coal producer can proceed to take depletion on coke (although there are individual producers of coal who are claiming depletion on more advanced products). Indeed, it carefully refrains from endorsing the Cannelton theory, arguing that all of the processes listed for coal are includible irrespective of any marketability test (Br., pp. 7–8, 13, 18).

We note further that we subscribe to National Coal Association's reading of the legislative history (brief, *amicus curiae*, pp. 15–16). We agree that cleaning, breaking, sizing and loading of coal were allowed because they were a normal part of preparation "at the mine for shipment"; that the processes specified for sulphur were allowed on the same basis; and that the purpose, in respect to other minerals, was to allow processes "which resulted in a product of a mine (i.e. mineral concentrates) as distinguished from a manufactured or refined product." *Id.*, p. 15.

5. Taxpayer's discussion of the legislative history (Br., pp. 76–105) is notable for what its does not argue. It fails to show that Congress' attempt to provide a reasonable specification of allowable treatment processes was designed, in any instance, to permit a producer to claim depletion on processes used to convert a commercially valuable mineral constituent into a new and different product.[33] It fails to meet the thesis, fully developed and documented in our main brief, that Congress expressed its determination to establish a cutoff at the point where the basic mineral product is obtainable, and thus to avoid preference of the integrated miner over the non-integrated miner. It ignores the Government's showing that all of the branches of the mining industry which requested percentage depletion sought it on the basis of the valuable constituent of the mining operation, not on the basis of products subsequently manufactured.[34]

Instead, taxpayer seeks to show (in keeping with its argument as to cyanidation and leaching, discussed

[33] Taxpayer does seek support (Br., pp. 93–94) from a letter written by Senator George to the Commissioner of Internal Revenue in 1955 on the subject of brick manufacture. This letter was written twelve years after the statutory definition of mining was adopted and four years after brick and tile clay had been granted percentage depletion—at a time when miners of clay located in Georgia and elsewhere were contending, in litigation, that they should be allowed depletion on brick. Assuming that this is appropriate "legislative history," the fact remains that the basis of Senator George's argument was that brick clay has "no commercial value" until made into brick—an argument which hardly aids Cannelton, since the Court of Appeals has found in this case that fire clay *does* have commercial value.

[34] See note 13, p. 17 *supra*.

above) that Congress proposed to allow certain alternative treatment processes, knowing that this would result in significant variations in the degree of refinement characterizing the treated mineral. As we have already indicated, and shall point out more fully below, such modifications as Congress made in 1943, when it wrote the statutory definition of "mining," were made precisely because Congress accepted an industry complaint that the Treasury, in applying the 1932 Regulations, was failing to allow certain *equivalent* processes which should have been allowed under the Regulations. Congress acted in order to assure substantial equivalence, not in order to permit significant variation.

Taxpayer advances a further argument based upon Congress' failure to act upon legislative recommendations made by the Treasury in 1954, 1958 and 1959.

We turn to these two lines of argument.

(*a*) In our presentation of the legislative history, we argued that the Treasury Regulations promulgated under the 1932 Act (Regulations which listed includible processes, App. B, p. 136) undertook to provide an industry-wide cutoff, and that Congress followed the same approach when it wrote the statutory definition of "mining" in 1943 (albeit it made certain additions to the processes named in the outstanding Treasury Regulations on the ground that those it was naming were equivalent to concentration and should not have been disallowed by Treasury, as they had been after 1940). Taxpayer argues, in response, that the 1932 Regulations, as published, did not reflect

either the Congressional intent or the actual understanding reached by the Treasury and the mining industry representatives (Br., pp. 84–85); that Congress, in 1943, showed that it rejected the approach reflected in the Treasury Regulations because it wrote into the statute various processes (cyanidation; leaching; the furnacing of quicksilver) which "go beyond concentration" (Br., p. 86); and that the 1932 Regulations and the 1943 statute have nothing in common beyond the fact that "both have four lists of processes" (Br., p. 91).

Taxpayer hinges its argument upon the conferences between mining representatives and Treasury officials in relation to the 1932 Regulations. It relies upon a statement by L. H. Parker (Br. 84–85)—made in 1947 on behalf of the National Coal Association and in a context having no relation to processes such as cyanidation, etc.—that the agreement reached at the 1932 conference (which he does not say he attended) was one which was *not* reflected in the 1932 Regulations *as issued*. Apart from the fact that Mr. Parker was obviously mistaken,[35] this is certainly not what Congress was told in 1942 when the mining industry sought legislation to reinstate the original (pre-1940) Treasury practice under the 1932 Regulations. Mr. McLaughlin, representing the Tax Committee of the American Mining Congress, advised Congress that he

[35] See the material submitted to the Treasury by the American Mining Congress, reprinted in taxpayer's Appendix II, pp. 132–160, and compare the original draft of these 1932 Regulations (App. II, p. 134) with the final Treasury Regulations 77 as issued (App. B, p. 135).

had participated in the conferences which preceded the adoption of the 1932 Regulations and that [36]—

> When the 1932 regulations were adopted, it was understood by the representatives of the mining industry that the omission of a complete recital of the many processes by which ores are *beneficiated* was simply to avoid burdening the regulations with a lengthy and possibly incomplete statement, and that the meaning of the act was met by the inclusion of phrases such as "other processes" which were deemed adequate to cover other common methods of treatment *similar in their function* to those specified. *With the regulations in this form,* it was believed that the administration of the law would not depart from what we had been informed was the intent of the Members of Congress who had sponsored the legislation.
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> * * * * *
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> That this understanding was well founded and expressed the agreement reached at this conference with Assistant Secretary Douglas is clearly borne out by the action of the Bureau of Internal Revenue for the next 8 years in accepting and settling tax returns based upon it. During this period, the law with regard to percentage depletion was repeatedly reenacted and the regulations remained essentially unchanged. For example, in the case of gold mines, common processes such as amalgamation and cyanidation were regarded as the *equivalent* of concentration by gravity or flotation, * * *. [Emphasis added.]

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[36] Senate Hearings, 1943 (App. B, pp. 202–203).

Mr. Fernald, Chairman of the Tax Committee of the American Mining Congress, also emphasized[37] that "[a]s to the Treasury interpretation, the original regulations prescribed that * * * a *cut-off* should be made at 'concentrating (by gravity or flotation) and other processes *to the extent to which they do not beneficiate the product to a greater degree* * * *,'" and that "under this regulation" the Treasury "in practice considered cyaniding as *substantially equivalent* to concentrating * * *" (emphasis added). Mr. Fernald has also explained (although not to Congress) that[38]—

> * * * After extended hearings on this subject [the proposed 1932 Regulations] before the Assistant Secretary of the Treasury, substantial modifications were made in the Bureau's original proposals and the Regulations as thus finally approved (Regulations 77, Art. 221) stood substantially unchanged until in 1940 when certain apparently minor changes therein were made in 1940 by T.D. 4960 (1940–1 C.B. 38). * * *

Other industry representatives who appeared at the hearings before Congress similarly placed emphasis upon cyanidation, leaching, and the furnacing of quicksilver as *equivalent* to concentration.[39] Mr.

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[37] Silver Subcommittee Hearings, 1942 (App. B. pp. 188–189).

[38] Fernald, *Depletion and Related Problems under the Revenue Act of 1942*, 21 Taxes, The Tax Magazine, 141 (1943) (App. B, pp. 483–484).

[39] Silver Subcommittee Hearings, 1942 (App. B, pp. 172, 174, 177, 178).

Fernald explained that the Treasury's early practice (which he sought to reinstate) permitted cyanidation to the extent that it did not go beyond concentration.[40]

The furnacing of quicksilver, applicable to only one mineral, was allowed on industry representations that it was an equivalent to other named processes and was necessary to obtain the marketable product.[41] Mr. Fernald, among others, told Congress that "the furnacing or retorting of quicksilver ores is generally regarded as the equivalent of concentration."[42] In contrast to taxpayer's statement that there was an early agreement with respect to the furnacing of quicksilver as a process going "beyond concentration" (Br. 85–86), Mr. Williston (President, Oregon Mining Association) stated that "when the ruling of the Treasury was passed, * * * quicksilver was not considered to be valuable, nobody paid any attention to it."[43]

The accuracy of taxpayer's declaration (Br., pp. 90–91) that Congress' specification of allowable processes bears no resemblance to the prior Treasury

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[40] *Id.* (App. B, p. 184).

[41] House Hearings, 1942 (App. B, pp. 152–153); Silver Subcommitee Hearings, 1942 (App. B, pp. 161–162, 165, 172–173, 188); Senate Hearings, 1943 (App. B, p. 203).

[42] Silver Subcommittee Hearings, 1942 (App. B, p. 188).

[43] *Id.* (App. B, p. 173).

Regulations " may be readily judged by a comparison of the two:

Treasury Regulations 77	*Section 114(b)(4)(B)*
(1) In the case of coal—cleaning, breaking, sizing, and loading at the mine for shipment;	(i) In the case of coal—cleaning, breaking, sizing, and loading for shipment;
(2) In the case of sulphur—pumping to vats, cooling, breaking, and loading at the mine for shipment;	(ii) in the case of sulphur—pumping to vats, cooling, breaking, and loading for shipment;
(3) In the case of iron ore and ores which are customarily sold in the form of the crude mineral product—sorting or concentrating to bring to shipping grade, and loading at the mine for shipment; and	(iii) in the case of iron ore, bauxite, ball and sagger clay, rock asphalt, and minerals which are customarily sold in the form of a crude mineral product—sorting, concentrating, and sintering to bring to shipping grade and form, and loading for shipment; and
(4) In the case of lead, zinc, copper, gold, or silver ores and ores which are not customarily sold in the form of the crude mineral product — crushing, concentrating (by gravity or flotation), and other processes to the extent to which they do not beneficiate the product in greater degree (in relation to the crude mineral product on the one hand and the refined	(iv) in the case of lead, zinc, copper, gold, silver, or fluorspar ores, potash, and ores which are not customarily sold in the form of the crude mineral product—crushing, grinding, and beneficiation by concentration (gravity, flotation, amalgamation, electrostatic, or magnetic), cyanidation, leaching, crystallization, precipitation (but not including as an ordinary treat-

" Compare the contrary view expressed in the brief of the National Coal Association, *amicus curiae*, pp. 15–16. The Association finds (*id*, p. 15) that the present statute "closely parallels" the 1932 Regulations and that the "processes enumerated * * * were clearly of the type which were regarded as processes which resulted in a product of a mine * * * *as distinguished from a manufactured or refined product.*" (Emphasis added.)

Treasury Regulations 77	*Section 114(b)(4)(B)*
product on the other) than crushing and concentrating (by gravity or flotation).	ment process electrolytic deposition, roasting, thermal or electric smelting, or refining) or by substantially equivalent processes or combination of processes used in the separation or extraction of the product or products from the ore, including the furnacing of quicksilver ores.

The sum and substance of the matter is that Congress, agreeing with the view that the approach should be industry-wide, adopted a statutory definition which calls for that approach; it disagreed with existing Treasury practice only in the sense that it concluded that Treasury, in applying its Regulations to certain situations, had failed to treat members of the same class alike. It expressly stated that the statute adopted in 1943 was "in accord with the original regulations and the Bureau practices and procedures thereunder," and was passed "to make certain" that the ordinary treatment processes normally applied by mine owners to obtain a marketable product "should be considered as a part of the mining operation."[45]

(*b*) For the period from 1943 to 1951 (when the last of the minerals allowed percentage depletion under the 1939 Code were added to the statute), taxpayer offers nothing which has bearing on the construction of the statute. It makes no challenge to our showing (App. B, pp. 316–466; chart following p. 500) that, during this period, as reflected in the testi-

[45] S. Rep. No. 627, 78th Cong., 1st Sess., pp. 23–24 (App. B, pp. 210–211).

mony of numerous industry representatives appearing before Congressional committees, the mining industry itself interpreted the statute as allowing depletion on the mineral in the basic form in which it was fit for sale or commercial use.

Taxpayer picks up the thread of the legislative history in 1954, seeking to draw favorable inferences from Congress' failure to enact certain legislative proposals.

In 1954, Congress considered, but failed to enact, a proposal which would have specified the processes which the brick and tile industry might include in the depletion base. Brick and tile cases were then pending in the courts, but none had been decided.[46] The Ways and Means Committee concluded (as stated in

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[46] The first of these cases, *Cherokee Brick & Tile Co.* v. *United States*, 122 F. Supp. 59 (M.D. Ga.), was decided June 4, 1954, and affirmed, 218 F. 2d 424 (C.A. 5th), January 21, 1955.

When percentage depletion was first extended to brick and tile clay in 1951 (along with certain other minerals, including fire clay and shale), the structural clay products industry (which mines and uses brick and tile clay) stated that the statute allowed it depletion on "the market value of the raw materials." *Brick and Clay Record*, Vol. 119, No. 5—November, 1951, p. 24 (App. B, p. 486). Thereafter, in January 1952, it decided that it was entitled to depletion on its burnt clay products because "[r]aw brick and tile clay does not have a commercially marketable value * * *." *Brick and Clay Record*, Vol. 120, No. 1—January 1952, p. 29 (App. B, p. 490). At the same time, it stated that the situation as to fire clay was "considerably different," because there was "regular commerce" in fire clay, and that "[e]ven those refractory producers who do not normally buy or sell such raw material will probably be required to establish a price for the self-mined materials." *Id.* (App. B, p. 487).

a press release, dated February 24, 1954, quoted at p. 97 of taxpayer's brief) that it would leave the matter "to be determined under existing law."

Taxpayer also finds significance (Br., pp. 98–104) in the fact that Congress has not acted on recent Treasury proposals, advanced after the Government had lost a series of cases in the courts. In 1958, the Treasury proposed legislation with respect to the brick and cement industries.[47] See Taxpayer's App. II, p. 115. However, no hearings were held and Congress gave no intimation of its views.

In 1959, the Treasury proposed legislation dealing with the cutoff problem for *all* minerals. Taxpayer's App. II, pp. 124–131. Hearings were held on this occasion and a great variety of views expressed. The representative of the American Mining Congress acknowledged that some "recent cases" had gone "beyond the original concept of the percentage depletion deduction * * *."[48] The Ways and Means Committee, how-

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[47] These were the industries involved in the *Merry Brothers* line of cases (*United States* v. *Merry Brothers Brick and Tile Co.*, 242 F. 2d 708 (C.A. 5th), certiorari denied, 355 U.S. 824) and in the *Dragon Cement* case (*Dragon Cement Co.* v. *United States*, 244 F. 2d 513 (C.A. 1st), certiorari denied, 355 U.S. 833).

[48] Mr. Lincoln Arnold, Chairman of the Tax Committee of the American Mining Congress, testified (House Hearings, 1959 (Hearings before the House Committee on Ways and Means on Mineral Treatment Processes for Percentage Depletion Purposes, 86th Cong., 1st Sess.), pp. 70–71):

"In recent cases the courts have ruled that a producer of minerals—as to which the statute does not specifically bar certain processes—may take depletions based on the value of the first commercially marketable product which he produces, without regard to the type of processes required to arrive at such product. This first commercially marketable product test can lead to the

ever, did not write a report. Instead, on January 12, 1960, its Chairman announced that the Committee had "agreed to defer further action on the cutoff point on percentage depletion until the Supreme Court hands down its decision on the *Cannelton* case." [49]

There is thus no warrant for taxpayer's suggestion that Congress has made a determination contrary to the Government's contentions and that the issue is "peculiarly one for legislative judgment" (Br., p.

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result that although two taxpayers are producing the same end-product, and are using identical treatment processes, one of them may be considered as engaged in mining with respect to all of his processes whereas the second, because of the existence of a market in his area at an earlier stage of processing—whether or not he can or does sell any of his products at that stage—may be considered as engaged in mining only until he reaches that earlier stage.

"However, in applying the marketability test, some courts have ruled in effect that if the production from a mineral deposit is sold at various stages of processing and the producer can show that he sold all that he could economically sell at each stage, then the portion sold at each stage is the first marketable product for that portion of the output of the mine, so that there are as many first commercially marketable products as there are stages of processing at which he sells.

"Thus, under this so-called saturation approach, if the taxpayer can overproduce his market at each stage of his processing, all of his processing would qualify as mining for percentage depletion purposes.

"The Mining Congress has reached the conclusion that the marketability test not only allows results which go beyond the original concept of the percentage depletion deduction, but also can produce unintentional discrimination between taxpayers employing the same treatment processes to produce the same end-product."

Taxpayer has filed copies of these Hearings with the Court.

[49] Congressional Record, Daily Digest, January 12, 1960, p. D10.

120). The issue is purely one of statutory interpretation. And if any inference is to be drawn from the "failure-to-enact" history, the inference is that Congress agrees that the existing statute should be authoritatively construed by this Court.

6. Taxpayer states (Br., p. 27) that the Government's position in this litigation is inconsistent with some 54 cases (listed in taxpayer's Appendix II, pp. 173–181). The listing is an indiscriminate one—the cases cited having been decided on various issues—and the statement will not bear analysis.

More than half of the cases listed represent instances in which the courts, accepting the view that there could be no "commercially marketable mineral product" until sales occurred, held that, in the absence of sales, depletion could be taken on all processes employed by the producer in order to obtain the product actually sold. As pointed out above, the *Merry Brothers* rule, which has been widely applied, particularly in the brick and tile field, does not aid this taxpayer. That line of cases does not suggest that the product on which depletion is taken may vary from taxpayer to taxpayer within the same class.

Indeed, the Fifth Circuit where *Merry Brothers* and most of the brick and tile cases were decided has made this explicit. In *Alabama By-Products Corp. v. Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930 (a case not included in taxpayer's list),[50] the taxpayer was a miner of coking

[50] Also missing from taxpayer's list are cases involving percentage depletion on oil and gas. See our main brief, pp. 44–46.

coals, who converted the coal into coke. Taxpayer's coal sales, which were few in number, did not establish the value of the coal because the sales were "forced" sales (p. 899). The court held that the value of taxpayer's coal was to be computed by reference to the representative market price for coal of like kind and grade (as specified in Treasury Regulations). It held further, as against taxpayer's contention that its coal had unique characteristics, that the term "'like kind' is a broad phrase contemplating the distinction between classes of property" (p. 898); that "all bituminous coals are of like kind, or of the same general property classification" (*ibid.*); that, viewed in this light, the sales by other coal producers established a "true market in commerce" (p. 899); and that the representative price established by other miners was binding on taxpayer even though taxpayer, had it sold at that price, would have operated *"at a loss"* (p. 900).[51] Thus, the Fifth Circuit apparently agrees that the test is a class or industry test, and that there is no room for Cannelton's taxpayer-by-taxpayer "profitability" approach.

A second large group of cases in taxpayer's list reflects controversies as to whether a particular process

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[51] The claim of the taxpayer in *Alabama By-Products* was a much more modest one than that advanced by Cannelton. It was not seeking depletion on coke, but was arguing that its coking coals had unique characteristics and that it should be permitted to compute value by a method other than the representative market price (at which price it could not have profitably sold). Under the Regulations, other methods are available to an integrated producer only if there is no representative market price for a "like kind and grade" of the mineral. See our main brief, pp. 95-96.

was or was not one required in order to put the mineral in marketable condition—for example, whether the mineral in question was marketable without grinding, bagging or some other process alleged to be ordinary and necessary. These cases, by and large, do not involve a conflict in approach.

The cases which plainly endorse taxpayer's "profitability" theory are the instant case, the subsequent decisions by the Eighth Circuit in *Commissioner* v. *Iowa Limestone Co.*, 269 F. 2d 398, and *Bookwalter* v. *Centropolis Crusher Co.*, 272 F. 2d 391 (petition for rehearing pending), and several district court decisions now pending on appeal. But see *Alabama By-Products* v. *Patterson*, 258 F. 2d 892 (C.A. 5th), certiorari denied, 358 U.S. 930.

III

UNDER THE GOVERNMENT'S CONSTRUCTION, THE STATUTE MAY BE READILY AND CONSISTENTLY APPLIED

Taxpayer suggests that there are serious difficulties in applying to an integrated producer who engages only in the sale of finished products a rule which would restrict his depletion base to the value of the basic mineral product. The answer is that Treasury Regulations, repeatedly approved by Congress, provide the appropriate methods for such computation.

The problem of restricting an integrated operator to income from the mining property is almost as old as depletion. As early as 1922, Treasury Regulations provided, "If the mineral products are not sold as raw materials but are manufactured or converted into a refined product, then the gross income shall be assumed to be equivalent to the market or field price of

the raw material before conversion" (Treasury Regulations 62, App. B, p. 6). The same principle was followed when percentage depletion was authorized for oil and gas in 1926. See our main brief, pp. 42–44.

When percentage depletion was extended to other minerals in 1932, Treasury, recognizing that not all minerals had the equivalent of a posted field price, adopted somewhat more elaborate regulations—regulations promulgated after extensive conferences with representatives of the mining industry. These Regulations provided that if a taxpayer applied processes other than those designated as allowable, he should compute depletion on one of two bases: (a) if there was a representative market or field price for the basic marketable product *of like kind and grade,* by reference to that price; (b) if not, by excluding from the depletion base the cost of all non-designated processes. Treasury Regulations 77, App. B, pp. 135–136. This was in accord with the understanding of Congress, which had been fully advised that integrated metal miners (who have long been the rule rather than the exception) [52] would be obliged to segregate and exclude the values created by smelting and refining.[53]

In 1940, Treasury modified the Regulations so as to provide that, in the absence of a representative market price, the integrated operator would be required to eliminate both the cost of excluded processing and the profits derived from such processing. Treasury Regulations 103, App. B, p. 145. Although this change was

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[52] Compare taxpayer's assertion (Br., p. 72) that integration is "the rule rather than the exception" for miners of fire clay.

[53] See main brief, pp. 46–58.

challenged by the industry, Congress refused to overrule the Treasury. Main brief, pp. 58–59, 60–64. This method of computation—the so-called "proportionate profits" test—has been in effect ever since.[54]

In 1945, taxpayers were accorded additional latitude. Thus, an integrated miner is now authorized to substitute another method for the "proportionate profits" method if he establishes to the satisfaction of the Commissioner that such proposed method will clearly reflect the gross income from mining. Treasury Regulations 111, main brief, pp. 95–96.

In the District Court, the Government argued that there was sufficient evidence to establish a representative market price for raw fire clay and shale of the kind and grade mined by Cannelton. We have not discussed this evidence in our briefs to this Court, since that issue was never reached below (both the courts below having concluded that the depletable product was sewer pipe). If the case should be remanded and the District Court should thereafter conclude that there is not a representative market price for raw fire clay and shale of like kind and grade, the "proportionate profits" test would apply.[55] Its opera-

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[54] For a discussion of this aspect of the Regulations, see *Alabama By-Products Corp.* v. *Patterson*, 258 F. 2d 892, certiorari denied, 358 U.S. 930. In situations where a taxpayer does not qualify for percentage depletion (compare taxpayer's brief, p. 111, n. 16), cost depletion is available. Section 23(m), main brief, p. 92; Treasury Regulations 111, Section 29.23m–2.

[55] In the District Court, government counsel erroneously stated that the portion of the Regulations prescribing the "proportionate profits" test was no longer in full effect. This mistake was of no consequence inasmuch as the District Court concluded that sewer pipe was the depletable product.

tion is no mystery. Taxpayer says (Br., p. 6) that its mining costs are $2.418 per ton. Presumably it is equally familiar with its non-mining costs. If it be assumed, by way of illustration, that the latter are nine times the former, then the depletion base would be one-tenth the price of sewer pipe (not ten-tenths, as taxpayer now figures it). The precise computation, of course, is one which should be made in the first instance in the District Court.[56]

Taxpayer poses (Br., pp. 112–115) a series of more complicated factual situations, none of which is before this Court. The difficulties presented by these hypothetical cases are not so formidable as they are made to appear. Suppose, for example, that this taxpayer mined two grades of fire clay and that it manufactured a low-grade sewer pipe from the less valuable clay and a high-grade sewer pipe from the more valuable fire clay. Assuming that there were no sales by Cannelton, or representative sales by others, of either grade, the "proportionate profits" method would apply. Since the high-grade sewer pipe would sell for more than the low-grade sewer pipe, use of that method would allow an increment for the higher grade of clay.

Moreover, to the extent that there are situations in which there are no actual sales to provide a guidepost and in which the "proportionate profits" method fails to take adequate account of special conditions or factors, the taxpayer is authorized to invoke a reasonable

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[56] We note parenthetically that the taxpayer has the burden of establishing the value of its fire clay and shale, not the Government.

alternative method of ascribing fair value to the basic mineral product. The only limitation is that such method fairly reflect the taxpayer's gross income from the mining operation in question. Compare the latitude which taxpayers enjoy and traditionally exercise in computing depreciation with respect to other types of capital assets.

To say that the Government's theory leads, in some instances, to the necessity of making constructive computations is perfectly true. And that is inevitably so, under any system of mineral depletion, unless the integrated operator is to be permitted to take depletion on the basis of his finished manufactured products, whatever they may be. Congress may have the power to authorize the absurd economic consequences and the gross and pervasive discrimination which this approach would entail. The evidence is plain that it has not done so.

CONCLUSION

For the reasons set forth in our main brief and those elaborated above, the judgment should be reversed and the cause remanded for further proceedings.

Respectfully submitted.

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